INFLATION: THE CHALLENGES FOR MONETARY POLICY

JEAN- CLAUDE TRICHET

The advanced economies thought they had attained the "Holy Grail of stability" in the 1990s and the first half of the 2000s: steady growth in real economies, low volatility of this growth around its average value, price stability and moderate inflation, with no episodes of abnormally low or high inflation. This situation, which followed on from the long period of major disinflation in the 1980s, was dubbed the "Great Moderation". Inflation, which was thought to have disappeared, has returned, and people were slow to recognise it. This raises two questions: how can we understand what happened, and what lessons can we learn for the future?

Jean- Claude Trichet

The Great Moderation

This period of Great Moderation is clearly reflected in the statistics. After peaking in France at 13.5% in the early 1980s, inflation fell below 3% in 1986. In the 1990s, French inflation averaged around 2%.

Very similar inflation paths were observed across Europe. In the United States, having peaked at 13.5% in 1980, annual inflation hovered somewhere between 3% (in 1992) and 1.60% (in 2002) from 1992 to 2007.

This period of Great Moderation came to an abrupt end in the advanced countries with the onset of the global financial crisis – the subprime crisis and the collapse of Lehman Brothers – in 2007-08. Almost all the advanced countries then experienced a two-fold setback compared with the previous 15 years: a severe recession in 2009, followed by a slowdown in real growth and, gradually, the appearance of abnormally low inflation, creating the risk of full-blown deflation from 2012 to early 2020, which marked the emergence of the Covid crisis.

The inflection point in inflation marked by the major financial crisis of 2008 in the advanced countries – and, by extension, in the global economy – appears to have had its reverse counterpart in the recent period. Indeed, in the first half of 2021, inflation gradually emerged on a scale not seen since the early 1980s.

In both cases – 2012 and 2021 – the sudden changes in the pace of inflation were not anticipated by the private sector, market participants or the authorities. In fact, they came as a great surprise since they contradicted the prevailing sentiment among economists.

Back in 2007, the belief in the Great Moderation, which had continued for a long time, with reasonable stability in growth and prices, was abruptly upended by a subsequent period marked by recession, very slow growth and nearly ten years of abnormally low inflation (from 2012 to 2020). Up until October 2021, there was broad consensus that a return to high inflation was very unlikely. This prediction was proved wrong by what was already happening in 2021, and what was to become the high inflation of 2022-23.

If we want to shed light on what has happened in the advanced countries over the last 15 years and attempt to predict what might happen in a long-term structural perspective, we need to answer the following four questions.

How can we explain the fact that for a period of around ten years, between the global financial crisis and the Covid crisis, we witnessed very low inflation with extraordinarily low short-term interest rates, which were even negative in Europe and Japan, and the justified conviction of central banks that the primary danger was the risk of deflation and no longer that of inflation?

What happened around the middle of 2021 in the advanced countries to explain the reappearance of inflation? Why, as a consequence, did all the monetary policies of central banks in advanced countries have to change considerably? What was the cause? Was it a single factor, or are there multiple explanatory factors?

Why was it so difficult for governments, economists, market operators and central banks to take full cognisance of the resurgence of inflation? Why did it take so long – around half a year – for the appropriate decisions to be taken when the return of inflation was so evident?

The final, and perhaps most important, question today is: what lessons can we learn from the past? Will central banks win the battle for price stability?

The disappearance of inflation?

- The first question is indeed: why did inflation seem to gradually disappear after the global financial crisis?

Why were many talented economists as well as market participants convinced that inflation would always be low, and even indefinitely very close to zero? We can identify five main reasons for this, without claiming to be exhaustive.

First, this situation, which lasted for around ten years, can be ascribed to the fact that the “scars” of the global financial crisis substantially lowered economic growth in the advanced countries compared with their previous potential growth. As a result, output gaps were negative, thereby pushing down inflation. These negative output gaps remained, even if we take into account the downward revisions to potential growth over the period, due in particular to the slowdown in productivity growth.

Second, we need to take into account the acceleration of globalisation. By systematically harnessing the division of labour at the global level, manufacturers have perfected new “international value chains” that enable them to achieve lower production costs. We know the role that China, Asia and the emerging economies generally played in this period of increasing and accelerating globalisation, which was a major cause of low inflation.

Third, we should not overlook the role played by the weakening of the bargaining power of trade unions, of “organised labour” and of workers and employees over a long period in the United States and many advanced countries. There was abnormally low growth in nominal and real wages in these places. Ultimately, inflation is closely correlated with changes in unit production costs, i.e. the result obtained by combining productivity gains and nominal wage increases. In a long-term perspective, very small increases in unit production costs lead to very low inflation. It should be noted that this phenomenon is much less marked in France, because of the way the national minimum wage operates and the considerable redistribution efforts that characterise our country.

Fourth, a factor that contributed to both low inflation and exceptionally low real and nominal interest rates was the so-called savings glut, a substantial excess of savings across the global economy. This savings glut, which was well documented by economists, partly explained the low inflation by virtue of low aggregate global demand relative to potential supply. It also explained the low real interest rates seen worldwide, where savings were significantly more abundant than investment.

Fifth, we must of course add that Covid, which marked the end of the period that began with the failure of Lehman Brothers, tended to further accentuate the phenomenon of very low inflation, with the constant threat of a synchronised implosion of national and continental economies, as well as of the global economy. This danger made it all the more pressing for central banks to resolutely combat the possible emergence of the risk of deflation.

Indeed, deflation, i.e. a generalised and continuous fall in prices, is particularly dangerous from the point of view of the proper functioning of the real economy. If prices keep falling, consumers tend to wait before buying most non-essential goods and services. The same is true for household investment. Businesses also put off investing until the price of machinery is lower. In a general way, the behaviour of all economic agents is inhibited by a generalised and continuous fall in prices. The threat of economic implosion due to deflation that might materialise had to be resolutely combated by central banks. They therefore pursued highly accommodative monetary policies on both sides of the Atlantic, with extremely low interest rates in the English-speaking countries and even negative rates in Japan and Europe. In addition to these conventional monetary policies, central banks gave forward guidance to the effect that they would continue to be monetarily accommodative over a long period, come what may.

Moreover, faced with the persistent risk of deflation, central banks in the advanced countries embarked on bold unconventional monetary policies, in particular with the generalised use of targeted longer-term refinancing operations (TLTROs) in the euro area, and above all with massive purchases of negotiable securities, mainly government, but also corporate. This quantitative monetary policy, referred to by market participants as quantitative easing (or QE), was designed to compensate for the lack of intermediation by private markets, to lower medium- and long-term market interest rates and to encourage private investors to invest in private assets that were riskier than government bonds.

The combination of conventional and unconventional policies resulted in a long and totally unprecedented period of extraordinary monetary accommodation by all the central banks in the advanced countries.

All in all, an estimate of the increase in the QE portfolios accumulated by the four advanced country central banks (the United States, the euro area, Japan and the United Kingdom) from the global financial crisis to the end of the Covid crisis indicates cumulative purchases of negotiable securities of around USD 25 trillion (USD 25,000 billion).

Why did inflation return?

- Without claiming to be exhaustive, we can identify eight main causes for the return of inflation.

First, the post-Covid recovery was a catalyst for inflation because the economies affected found themselves suddenly and in a largely synchronised manner in a situation – very happily after the unprecedented trauma they had just gone through – in which the restrictions associated with Covid were rapidly lifted for consumers. Many consumers had not only the desire but also the ability to consume, because both monetary and fiscal policies had been very accommodating. The famous, and in some respects unfortunate, “whatever it costs” policy in France was also seen in many other countries. There was thus a “hunger to consume” and a huge amount of new demand financed by previous forced saving, even though Covid had considerably disrupted production and its after-effects were still evident.

Among the unanticipated consequences of Covid, there were also changes in the behaviour of many working people, who wished to change occupation, making it even more difficult for supply to meet demand. This mismatch between strong demand and insufficient supply of goods and services can be dated approximately to the first half of 2021 on both sides of the Atlantic: as early as the first half of the year in the United States, and the middle of the year in Europe. This is how the first inflationary movement was triggered.

Second, governments, executive authorities and central banks waited before taking the necessary decisions. This delay, which has already been mentioned, of at least six months was regrettable: the emerging inflation met with no immediate response in terms of monetary policy. This was also of course the case with respect to fiscal policy.

Third, since extremely accommodating and expansive monetary policy had been pursued over a decade, the economies of the advanced countries found themselves with a considerable stock of "central bank money" or "base money", swollen in particular by the accumulation of commercial bank reserves at central banks as a result of the massive purchases of negotiable securities. This is not to criticise past policies: they were necessary given the threat of deflation. But the legacy of ten years of extraordinarily accommodative monetary policies was there, and still is today.

Fourth, in addition to everything we have just mentioned, there was the legacy of fiscal policy that had also been very accommodating in all the advanced countries, even more so in Japan and the United States than in Europe, and considerably more so in all countries during the pandemic. It is likely that in the United States the initial acceleration in inflation in 2021 was due, as noted by Larry Summers, former Treasury Secretary under President Clinton, to more expansive than necessary fiscal policy at the start of the Biden administration.

The first two causes mentioned are cyclical in nature. The subsequent two are both cyclical and structural in nature, and their real impact will depend very much on the design and continuity of new policies implemented in the monetary and fiscal areas. The next three causes, which will now be outlined, are structural rather than cyclical.

Fifth, while the acceleration of globalisation had been a powerful factor for disinflation, the very dynamic of globalisation has been substantially reversed: Covid, the risks of disruption to supplies due to pandemics, sanctions, geostrategic tensions, wars and the risk of war in the world have led all producers to cease basing their production entirely on their participation in extended global value chains, which are now regarded as more vulnerable than before. Corporations and producers, but also countries themselves, are now seeking to insure themselves against the risks associated with too great a global division of labour. The new US legislation, the 2022 Inflation Reduction Act, is a prime illustration of this, as it includes a raft of incentives to locate key production facilities in the United States. This trend towards less globalisation, or even de-globalisation, especially in certain sensitive areas of high technology and healthcare products, is a long-term structural development. It is one of the possible causes of inflationary pressures in the short, medium and long term, just as the acceleration of globalisation proved to be a driver of disinflation.

Sixth, another structural factor, which had fostered very low inflation in recent years, now seems likely to have the reverse effect. The example of the United States is illuminating: for a very long time, so-called blue-collar workers and, more generally, the lower middle class have seen their pay stagnate and the gaps in income and wealth widen. The issue of inequality, which had previously been seen as essentially an economic one, has become a major political problem. The American political cycle of the last seven years – the campaign and election of Donald Trump and then Joe Biden – can be interpreted as a blue-collar revolt, with these voters deserting the Democratic Party to vote for the Republicans, thereby forcing their traditional party to change its own terms of reference and domestic policies. What is known as populism, which is particularly striking in its emergence and persistence in the United States, can be seen to varying degrees in all countries. It seems likely to me that the new perception of income and wealth inequalities as a core political issue in most advanced economies may significantly alter the way in which wage and other labour negotiations are conducted. The long period of weak bargaining power, virtually no increase in unit production costs and, as a result, inflation durably close to zero, may be coming to an end.

Seventh, the necessary green transition raises new questions regarding its cost. This transition is an imperative that is beyond dispute, but there is often a temptation to present it as a win-win process in all respects. It will simultaneously avert the dangers of global warming, boost growth and create many new jobs. The reality is a little different. We will have to invest in new production processes over the long term, and finance these massive investments, which will be largely simultaneous at the global level, since all the world's economies, without exception, must contribute to this transition. Moreover, much of the capital stock we currently have is becoming and will become obsolete.

It is a fact that we will have to reach our targets rapidly in a global economy that has already fallen considerably behind on the goals set in 2015 by the Paris Agreement, and which also faces many other problems (the systemic fragility of the globalised economy, a lack of social cohesion, the impact of digital technologies, and geostrategic tensions in particular). Preserving the planet has and will have a cost that will inevitably become apparent to all our fellow citizens. In particular, the period of excess savings relative to investment at the global level will gradually come to an end. As a result, we can expect higher real interest rates worldwide and stronger inflationary pressures: all other things being equal, aggregate global demand is likely to be higher than previously.

Eighth, I must mention a cause that I fervently hope will be only conjunctural and not structural: the war in Ukraine. I mention it last, which is not to say that it is not having dreadful consequences and that it is not a substantial cause of inflation. It should be noted that this war, which is being waged in Europe, is affecting our continent significantly more than the United States. At the time of writing the draft of this article (March 2023), the difference in total inflation on either side of the Atlantic was around 2% (5% in March 2023 in the United States and 6.9% in the euro area). Yet core inflation (i.e. inflation excluding energy and food) was about the same in the two major advanced economies (5.7% in the United States, 5.6% in the euro area). In other words, the impact of the European war on the additional price of energy and food in Europe compared with the United States was around 2%.

These figures were not the same at the end of year 2023: in December 2023, headline inflation was around 2.9% in the Euro area where core inflation was 3.4%. This is to be compared to the November figure in the US with headline around 3.1% and core around 4% (the December figures are not available yet as January 2024). Headlines inflation are very close now on both sides of the Atlantic. This is not surprising: inflation being measured over 12 months, the initial very negative impact of the war in Ukraine for Europe is no more visible in annual the inflation figures even if it is still present, of course, in the overall price levels.

It seems to me, however, that it would be naïve to attribute everything to this terrible war, as some people are tempted to do. The current inflationary episode is multidimensional, at once cyclical and entrenched, conjunctural and structural, and really began in mid-2021, several months before the invasion of Ukraine on 24 February 2022. The seven causes mentioned above should therefore not be overlooked or underestimated, even if it remains clear that the prices of energy, gas and oil, certain raw materials, cereals, etc., have risen significantly as a result of the war. This additional inflationary cost is negative for everyone worldwide.

We can try to persuade ourselves that this war in Europe will not necessarily last very long. If it were to be prolonged, it would be very serious for the whole world, for many reasons. It would also be the cause of a persistent higher level of prices, which would hit Europeans particularly hard.

Then there are the persistent tensions all over the world, particularly around Taiwan, and the war between Israel and Hamas. These geostrategic threats are also among the potential inflationary factors at the global level.

A difficult assessment

- The third question is: how can we explain in retrospect the initial delay, the hesitation of the public authorities, economists and markets, when the return of inflation was already apparent?

On this subject, we may recall that Jay Powell, Chairman of the US Federal Reserve, was saying until the end of October 2021 that the inflation we were seeing was transitory, and that we would get back to price stability, around 2%, in the course of 2022. We saw what then happened. He was obviously saying this with the sense that it was neither impossible nor absurd. Market participants listened to him. Economists themselves were convinced that we could reasonably return to price stability fairly quickly. It was in November 2021 that the Fed changed its tone, stating that inflation was no longer “transitory”, but “sticky". But the appropriate decisions on interest rates were not taken until around five months later. The same time lag can be seen in Europe between the recognition that inflation was not transitory and the first interest rate rises.

To be sure, on both sides of the Atlantic, some signals of a return to less accommodative policies had already been given, in particular the progressive reduction of QE, with a view to ending the net purchases of negotiable securities (in early March 2022 in the United States and in July of the same year in the euro area).

We should note that, for reasons that can be explained by the fact that the shock in Europe was more a supply shock than a demand one, there was also a lag of a few months between the first US rate hike (in March 2022) and the first European rate increase (in July 2022).

In setting out the five reasons for the delay as I have analysed it, I do not overlook the fact that the central banks then raised interest rates promptly and substantially, both in the United States and in Europe. They took a series of rapid decisions that proved their resolve. The interesting thing in analysing the initial delay is to see that multiple factors were at play.

1. It is not so easy to correctly identify a development that we might have thought was primarily a supply shock. Central banks must always be cautious when characterising the inflationary shock they are faced with. If it is essentially a supply shock, then it is more difficult for them to act and it may be appropriate, in some specific cases, simply to "ride out" the temporary shock without taking very substantial action, beyond avoiding "second-round" effects. If it is a demand shock, then they need to act decisively to dampen demand. With the benefit of hindsight, we can see that central banks on both sides of the Atlantic were dealing with a simultaneous demand and supply shock. There was therefore a need to act, and to act more and faster in the United States, where the demand shock was clearly more pronounced than in Europe. But we acknowledge that it took a certain amount of “meditation” before being certain of the assessment to be made.

2. The common belief among economists was that there was no convincing reason why all the factors I have set out as explanations for low inflation and the threat of deflation should have changed substantially. Why, they thought, should we have entered a different period? Their immediate analyses were not sufficiently clear-sighted and/or bold to suggest that our economies might indeed be in a very different environment. This misguided belief had been reinforced in the global economic conversation by many eminent economists, who were firmly convinced that low inflation was a very long-term phenomenon along with near-zero interest rates, which should be taken advantage of over the long term.

3. There is another important element that needs to be considered: among the conventional and unconventional measures taken by central banks, there was also – and this has already been mentioned – forward guidance about what was going to be done over the long term. During the period when the threat of deflation was looming large, all of the central banks had no hesitation in stating that they would continue to be extremely accommodative over the long term, come what may. When the time came to change policy, the necessary change was made difficult by the previous commitments. This is a common sense observation, which shows that we will have to be more cautious in the future about these kinds of unconditional ex ante commitments.

4. Central banks on either side of the Atlantic had closely coordinated the use of their unconventional instruments, i.e. the purchases of negotiable securities on the markets (QE), with that of their conventional tools, i.e. interest rates. They had stated that they would only start to raise interest rates once they had stopped their net purchases on the markets. This was the forward guidance given on both sides of the Atlantic. This introduced an additional delay: the two major central banks, the Fed and the European Central Bank (ECB), had to wait until they had completed their net quantitative purchases before raising interest rates. The lesson to be drawn from this is no doubt that these two types of monetary policy should not be so closely linked.

5. The unreliability of the prevailing economic models at a time of extremely rapid economic, monetary and financial change is a serious problem. The neo-Keynesian Dynamic Stochastic General Equilibrium (DSGE) models that predominate in all the analyses of the private and public sectors, market participants and central banks alike, are not necessarily equipped to take account of very rapid changes, or abrupt "phase transitions", to use a metaphor from physics. If Jay Powell was still able to say in October 2021 that we were going to get back to 2% in the course of 2022, it was because his staff's models were producing results that did not contradict his public statements. It was the same thing in Europe for Christine Lagarde. The same phenomenon was seen in the period following the bankruptcy of Lehman Brothers. To take the example of the ECB, the economic models used at the time, and indeed those used by all central banks, as well as the private sector, did not tell us that national economies and the European economy were going to suddenly collapse in the three quarters following the failure of Lehman Brothers (in the last quarter of 2008 and the first two quarters of 2009). The projections calculated did not correspond at all to the reality reported directly by the economic agents immersed in the real economy, i.e. businesses, entrepreneurs, retailers and trade unions. The very serious economic developments apparent to businesses and consumers were not taken into account by the DSGE-type models. The data recorded, quarter after quarter, proved the economic agents surveyed directly right and the models wrong!

A return to price stability?

- Will central banks win the battle to restore price stability?

On both sides of the Atlantic, they should be able to restore price stability in line with their definition, i.e. around 2%, over the medium term. This does not mean that the process of returning to stability will be straightforward, for all the reasons that have already been outlined. Inflation, when it has appeared, is highly asymmetrical. It is easy and quick to see inflation rise and take hold, but it is a long and laborious process to regain control of it. The metaphor of toothpaste that comes out of the tube easily but only goes back in with great difficulty is apt.

Added to this is the fact that the economic and financial environment for advanced countries and the global economy is an extremely uncertain one. It is marked by major forecasting difficulties associated with the war in Ukraine, geostrategic tensions and all of their repercussions on the confidence and decisions of economic agents. The global economy could also suffer an endogenous financial crisis like those we have seen in the recent past, which have disrupted it considerably.

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The global financial system remains overleveraged and is probably, because of inflation and the resulting rise in interest rates, even more fragile than in 2008. The events at the US regional banks and in Switzerland are an illustration of this. It should be noted that the "non-bank" financial sphere is also vulnerable, even more so than the banking sector. Many segments of this market are highly leveraged, and crises are to be feared when the entities concerned have to refinance at higher interest rates. Extreme caution and vigilance are required on the part of the authorities and the private sector alike.

There are therefore many reasons to believe that the task of central banks will be an extremely difficult one. However, it does not seem unlikely to me that core inflation could be around 2% over the course of 2025. There are three main reasons for my relative optimism.

First, central banks have shown great determination after their initial hesitation. Between March 2022 and July 2023, the Fed raised interest rates 11 times, with a total increase of 5.25%, including four consecutive hikes of 0.75%. Since July 2023, US interest rates are hold steady. This is unprecedented in the United States. In the euro area, the ECB raised interest rates 10 times between July 2022 and September 2023, with a total increase of 4.50%, taking the deposit rate up to 4.00% from its negative starting point of -0.50%. Since September 2023, ECB interest rates are also hold steady.

It should be added that the rhetoric of central banks has also been very firm, with all the major advanced country central banks reaffirming their objective of returning to price stability of around 2% over the medium term. This reaffirmation on both sides of the Atlantic is particularly noteworthy, especially given that the Fed did not announce its medium-term price stability target of 2% until 2012, after the global financial crisis. The Fed could have used the strong resurgence in inflation as a pretext to change its definition (3% ? 4% ?) or to return to its previous status quo, which included neither a target nor an arithmetical definition of price stability.

Second, one of the reasons for legitimate measured optimism is that the four major central banks of the advanced countries that issue the convertible currencies making up the basket of Special Drawing Rights (the Fed, the ECB, the Bank of Japan and the Bank of England) have reaffirmed their objective of 2% inflation over the medium term. The fifth currency in the basket is also very important: the renminbi, which is not yet freely convertible. However, since the decisions taken by the ECB when it was set up and further clarified in 2003, by the Bank of England and the UK government on 10 December 2003 when the latter was considering joining the euro area, by the Fed in January 2012 and by the Bank of Japan in April 2013, the 2% target and/or the definition of medium-term price stability at 2% are common to these four central banks. Due to these four decisions, and as long as they are confirmed, the international monetary system possesses a *de facto* "nominal anchor".

This remarkable convergence was not decided by international accord or by prior informal agreement between the central banks, but arose out of the analysis made by each of them in parallel after the global financial crisis, according to which a solid anchoring of medium-term inflation expectations was a necessary, if not sufficient, prerequisite for price stability. The remarkable convergence on the figure of 2% was spontaneous and independent.

This is an absolutely momentous development. For the first time since the dismantling of the Bretton Woods system, the international monetary system has – as we have just seen – a nominal anchor common to all the major convertible currencies. The fact that this nominal anchor has thus far not been called into question by any of the central banks concerned, either during the devastating Covid-19 crisis or during the recent resurgence of inflation, is further reason for measured optimism about the chances of a successful return to price stability in the medium term.

Finally, the third reason for this optimism is that, despite a strong inflationary surge for almost two years, medium-term inflation expectations do not appear to have been destabilised. If we look at the euro area, the projections of professional forecasters issued in the fourth quarter of 2023 stand at 5.6% in 2023 and 2.7% in 2024. In 2025, inflation is expected to be at 2.1%. These forecasts are encouraging, and of the same order of magnitude as the views of the ECB in its December 2023 projections: inflation for 2023, 2024 and 2025 is expected to be 5.4%, 2.7% and 2.1% respectively. The information that can also be extracted from the financial markets, in particular estimates of inflation in a long-term perspective (average future inflation from year 5 to year 10), does not point to a destabilisation of the inflation anchor either in Europe or in the United States.

Four lessons

- As has already been pointed out, a return to price stability is possible and even probable, but remains difficult. Central banks could learn at least four lessons from recent events if they are to maximise their chances of achieving it.

Lesson one: forward guidance is always useful in periods of calm when there are no unforeseen economic, financial or monetary structural changes. But such indications should be accompanied by a clearly stated proviso: whatever the forward guidance given, the sudden emergence of exceptional circumstances or threats of inflation or deflation always requires immediate action by the central bank.

Lesson two: there is a strong case for thinking that the two main tools of monetary policy today – interest rates (conventional) on the one hand, and purchases of negotiable securities (QE – unconventional), on the other – should be independent of each other. Too much interdependence can lead, as we have seen in the very recent past, to the postponement of measures that should best be taken quickly in the event of unforeseen structural changes.

Lesson three: we must never forget that the prevailing economic models have their limits. In particular, neo-Keynesian models of the DSGE type (which are very useful, indeed indispensable in periods of relative calm) do not capture the very rapid changes observed in periods of crisis. The models used in 2021, on both sides of the Atlantic, by the public sector and central banks as well as by the private sector were biased towards predicting a short-term, transitory surge in inflation, which would therefore not last. In the event of unexpected structural changes, we should be ready to extend our investigations by using unconventional models, including, and perhaps above all, information gathered directly and in real time from economic agents, companies and retailers.

Lesson four: the recent, albeit modest, changes in the strategic concept of monetary policy adopted in the United States and the euro area – in particular the Fed's pursuit of an "average inflation" target of 2% over time, which means that it allows itself periods of inflation above 2% to offset previous periods of inflation below the target, and the similar statement by the ECB, which similarly accepts "transitory periods" in which inflation may be above target – are not necessarily helpful at a time when the main challenge for central banks is to counter a surge in inflation.

These changes were certainly understandable when the decisions were taken, since the principal challenge at the time was to fight deflation. But they are no longer necessarily desirable when the major issue becomes that of combating inflationary pressures. It seems to me that this has been recognised de facto by the boards of the two leading central banks.

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In conclusion, it is important to emphasise how important price stability is for very powerful economic reasons: it enables optimal economic decisions to be taken in a context of predictable medium- and long-term stability, ensuring that expectations are firmly anchored. This explains the conceptual convergence of the major advanced countries and a large proportion of the world's other economies. This remarkable convergence can be seen not only with respect to price stability itself, but also with respect to the common definition of that stability: a 2% rise in prices over the medium term.

In addition to the economic considerations, there are no less important aspects relating to social cohesion and justice. The most disadvantaged and vulnerable members of our societies are always those who suffer most from inflation, which they cannot effectively protect themselves against, unlike the wealthy, and from deflation, which causes an overall contraction of the economy, with all the attendant difficulties for the poorest.

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Sincerity
“You don't have to succeed, you don't have to compete
with the devices that vulgar ambition permits itself;
You just have to be sincere.”
Ernest Renan (1823-1892), 6 December 1871,
Complete works, I